

# Work Comp Insights

Winooski Insurance Agency - Your Workers' Compensation Partner

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## Claim Reserves Explained

When a workers' compensation claim takes place within an organization, it's critical for the insurer to supply the funds necessary to cover the cost of the claim. That's why claim reserves are essential.

Put simply, a claim reserve refers to a specific amount of money that an insurer sets aside for paying an organization's workers' compensation claims. The level of funds within a reserve is determined by a claims adjuster, who makes an informed estimate of how much an organization's claims will cost.

Accurate claim reserves play a crucial role in helping organizations and insurers alike ensure financial stability when workers' compensation claims occur. What's more, insurers are legally obligated to maintain adequate claim reserves under several standards—namely, the [Sarbanes-Oxley Act of 2002](#).

Review this guidance to learn about how claim reserves are developed, the importance of having accurate reserves and steps for ensuring sufficient reserves.

### How Are Claim Reserves Established?

Upon the initial onset of a workers' compensation claim, a claims adjuster will be responsible for determining how much money should be initially allocated to the associated claim reserve. Seeing as the claims adjuster must make this decision early on in the claim process—likely before the ill or injured employee has received an exact treatment and recovery regimen—the adjuster has to make

an informed estimate regarding the anticipated claim expense and subsequent reserve amount.

In order to do so, the adjuster must consider potential claim costs stemming from the following categories:

- **Medical**—This category refers to expected expenses for the ill or injured employee's medical diagnosis and treatment. Such costs may include those of hospital or physician visits, diagnostic testing, specialist care, prescriptions, physical therapy appointments and any transportation necessary for obtaining treatment.
- **Indemnity**—This category consists of anticipated costs related to the ill or injured employee's ability to return to work (if at all) and resulting benefits. Depending on the severity of their condition, the employee may be entitled to disability or vocational rehabilitation benefits. If the employee is fatally ill or injured, their family may be entitled to death and dependent benefits.
- **Expense**—This category pertains to a wide range of assumed claim costs. In particular, this may include legal expenses (e.g., defense attorney payments, court costs and state filing fees) and medical management expenses (e.g., triage nurse charges and case manager costs).

The claims adjuster may estimate the initial expenses for each of these categories based on information from the employee's latest medical reports, as well as analyze past claims involving similar illnesses or injuries to deduce such costs. As time progresses and new information related to the claim presents itself (e.g., medical prognosis changes or treatment alterations), the adjuster may either increase or decrease the initial reserve amount. However, the goal is for the initial reserve amount to be as accurate as possible, with minimal adjustments necessary.



### The Importance of Accurate Claim Reserves

Maintaining accurate claim reserves is a crucial practice. After all, failing to do so can result in financial consequences for both organizations and insurers. In the scope of organizational impacts, overvalued claim reserves can lead to overstated underwriting calculations and—in turn—increased premium costs.

On the other hand, undervalued claim reserves can distort organizations' economic outlooks—making them appear more financially stable than what they really are. Undervalued reserves can also force claims to remain open longer until they can be fully paid off, often heightening organizations' claim-related expenses overall.

As it pertains to insurers, inaccurate claim reserves can lead to elevated loss ratios and insolvency concerns. This is because actuaries utilize reserve amounts to help determine organizations' risk levels and resulting premium rates. With this in mind, the presence of inaccurate claim reserves could lessen actuaries' premium calculation capabilities and motivate insurers to increase their risk appetites to more than what they can feasibly handle—potentially causing widespread financial hardship.

### Ensuring Sufficient Claim Reserves

Although insurers are ultimately responsible for maintaining sufficient claim reserves, here are some steps that organizations can take to ensure reserve accuracy:

- **Communicate with all parties.** Make sure to frequently communicate with all parties involved in the claim process—including the insurer, the ill or injured employee and the medical provider—to remain updated on the employee's medical treatment and anticipated claim expenses. If it hasn't already, request that the claim be closed out once the employee is healed and treatment has concluded to refrain from leaving it open longer than necessary.
- **Conduct routine reviews.** Consider working with claim representatives to engage in

routine, organizational claim reviews. Doing so will shed light on typical claim costs and allow for an analysis of whether past reserve amounts provided adequate funding for their associated claims.

- **Watch for red flags.** Keep an eye out for potential reserve issues throughout the claim process. This may include:
  - **Claim inconsistencies**—This problem can occur when an employee has several treatment steps ahead of them, but the claim reserve is nearly depleted. Alternatively, an employee may be close to full recovery, but the claim reserve still has significant funds leftover.
  - **Stair-stepping concerns**—More common in long-term claims (e.g., one year or greater), this issue can arise when the claim reserve must be frequently raised in small increments over time due to a lack of initial reserve planning.
  - **Major reserve changes**—This problem can occur when the claim reserve needs to be adjusted by 10% or more. While this issue isn't always a red flag, it could be indicative of a larger problem if such adjustments happen right before a claim closes or don't coincide with the latest claim information.
- **Consult an auditor.** If ongoing claim reserve issues occur, consider working with an independent auditor as a last resort. This auditor will be able to investigate current reserve practices and provide corrective guidance as needed.

Contact us today for additional workers' compensation resources.